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The influence of Trade Liberalization on Deindustrialization

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Abstract: *This paper deals with the different debates for and against free-trade. Secondly, it analyses the impact of policy liberalization (especially trade policy) on the industrial sector of an economy. And lastly, we analyze the impact of free-trade policy on Pakistan's manufacturing concern and we empirically show that there is a negative correlation between Trade openness and manufacturing output of Pakistan. The question arises 'Why the industrial sector?' This is because the industry is the lifeblood of any economic system. Increase in industrial output causes growth in all other sectors, such as services sector, fiscal sector and the substructure. The manufacturing sector is the locomotive of development. It improves the macroeconomics variables of an economy such as GDP, exchange rate, interest rate etc. In 1950, the share of manufacturing in a sample of 29 of the largest developing countries was 11 per cent, compared to 31 per cent in 16 advanced economies. To move forward from an agro based economy, the next logical step is an industrialized society. Furthermore, we have also examined the models of countries that have performed growth miracles without following the IFI's cookie cutter policies of structural adjustment and free trade; like the Asian Tiger Economies.*
Keywords: *liberalization, free trade, deindustrialization,*

I. Introduction

This paper analytically digs into the issue and the answer to the question is not in the affirmative. Asad Zaman (2005) states that a long journey of mind and heart since I first began to suspect that all that I had been taught, in the finest universities in the USA with many Nobel Prize winners among my teachers and colleagues, was questionable. The first step was when I read Paul Bairoch Economics and World History: Myths and Paradoxes, which provided empirical evidence on several historical episodes that economic development, had occurred as a consequence of restrictions on trade, and depressions resulted as a consequence of free trade policies (Bairoch and Kozul-wright, 1996).

But unfortunately the International Financial Institutions (IFI's) like the World Bank and International Monetary Fund (IMF) follow an altogether different ideology. They are the followers of Friedman and David Ricardo's theory of free trade and comparative advantage. Friedman (2006) sometimes called as the 'intellectual Freedom Fighter' believed in the market mechanism of self-regulation in other words 'no regulation. He believed the existence of an invisible hand that brings markets into equilibrium. Perhaps that invisible hand is not that gracious, as it takes money out of people's pockets to stabilize the markets. Friedman believed in a positive correlation between policy liberalization and growth. A lot of literature is available in support of Friedman's ideology.

The economic theory of free trade is an application of Laissez-Faire to international relations. It says that it is best for all nations to not put any restrictions on trade. This is among the most widely believed and fervently advocated ideas of economists. It is an excellent illustration of the idea of power/knowledge. This theory was invented in England, after it had acquired a fifty year lead over the rest of Europe in industrialization. As Bairoch (1995) has shown, adoption of this theory in Europe led to a recession in European economies and a boom in the English economy'.

II. Literature Review

It has been acknowledged that the instability and human insecurity left in liberalization's wake. They have cited statistical evidence that free trade can harm the ecology of the marketplace and have negative effects on poor countries. For example, the World Bank estimates that the number of people in the world living on less than $2 U.S. Dollars (USD) per day has risen by almost 50% since 1980. This correlates precisely with the period of the most worldwide trade liberalization in recent history. The implication of many of the arguments against trade liberalization is that trade negotiations should focus first on fairness to developing countries, rather than further opening up the markets of the poorest countries to competition (Kaplinsky 2001; Prasad et al., 2000).

Moritz Cruz (2008) state that in general, historical evidence indicates that in making trade an engine of economic progress, countries during the initial stages of their development benefited from static and dynamic gains of trade by applying policies outside the conventional rhetoric of free trade. They used, instead, trade

barriers to protect their infant industries from external competition, actively adopting trade and industrial policies that included, among others, infant industry protection and export subsidies For this reason, 'historically, relatively high tariffs have accompanied major waves of industrialization' Even in today's globalized world, there is not a single developed country that does not apply some sort of industrial policy, or claim to be totally opened' Developing countries lose not only employment opportunities, but also their autonomy with respect to economic policy and impose additional obstacles on the road to industrialization and growth

Matusz and Tarr, (1999) states that WTO puts too much emphasis on 'free' rather than 'fair' trade. These outcomes may include a reduction in employment and output, the loss of industry- and firm-specific human capital, and macroeconomic instability arising from balance-of-payments difficulties or reductions in government revenue. The size of the adjustment costs depends on the speed with which resources make the transition from one sector to another.

Ansari (2005) expresses his views in these words "The United Nation Industrial Development Organization's (UNIDO) annual review of industrial performance contains important insights for Pakistani policy makers. It provides overwhelming evidence to show that Pakistan is rapidly losing ground in world manufacturing market. We see that policy liberalization has seriously hurt Pakistani manufacturing competitiveness in world markets"

Zaman (2009) states that to bring this out more vividly, consider the proposition that free trade between two nations will bring benefits to both. To establish this, the economist has no need look at data regarding types and volumes of goods being traded, variations in trade barriers such as customs duties, and historical experience of countries under different trade regimes. Instead, using a pencil and paper, he will draw a convex production possibility frontier, and show how this expands for both countries under free trade, making Pareto improvements possible for both. Thus this theorem, widely believed by the vast majority of economists, is a universal truth. To recommend it as a policy to a country, we do not need to know what goods it produces, how they are produced, what is going to be exported, what will be imported, or any specific details about the geography of the country . None of the textbooks on international trade see any need to verify whether countries have convex production possibility frontiers (this is seen as a logical necessity); whether they have productions on this frontier, whether trade actually works in the way the textbook theory suggests. Most economists are not even aware of the historical data examined by Bairoch and Kozul-Wright (1993) which shows many episodes where countries which adopted free trade policies suffered from a recession as a result, and conversely, trade restrictions led to increased growth.

Vlad Spanu (2003) stated that the increase in the poverty in the developing world is happening while international institutions and industrialized countries promote the globalization and free trade. Developing countries are being increasingly pushed to a noncompetitive situation. Social groups in the North, as well as countries in the South, view governments of developed world as having double standards—advocating for openness and keeping exports of developing countries down by charging tariffs as high as 550 per cent for the developing countries.

Moreover the policy liberalization is destroying Pakistani manufacturing. We continue to pursue a suicidal low, wage labor, repressive industrial strategy that bloats profits for textile and sugar Seths. The production of complex goods in capital goods industries is neglected and imperialist agencies such as the ADB and the World Bank continue to laud the immiserising and detechnologising growth in the manufacturing sector. Promotion of complex capital industry products is essential for the transition to industrial maturity, flexibility and the move to activities with higher levels of income elasticity's of demand in world markets. Abandoning policy liberalization is essential if we are to move from globally declining industries such as textile and leather and vehicle assembly operations.

Weisbrot et al. (2002) states that the removal of all of the rich countries' barriers to the merchandise exports of developing countries—including agriculture, textiles, and other manufactured goods—would result in very little additional income for the exporting countries. According to the World Bank's estimates, when such changes were fully implemented by 2015, they would add 0.6 percent to the GDP of low and middle- income countries. This means that a country in Sub-Saharan Africa that would, under present trade arrangements have a per capita income of $500 per year in 2015, would instead have a per capita income of $503.

Santos-Paulino and Thirlwall (2004) has attempted to estimate the effect of trade liberalization on the balance of trade and the balance of payments for 22 developing countries that have adopted trade liberalization policies since the mid-1970s. He reports that trade liberalization has largely resulted in the worsening of the balance of trade and payments. Based on the evidence presented in their study, Santos-Paulino appears to argue that developing countries should not embrace trade liberalization polices without giving due consideration to its potential harmful effect on growth of output and living standards.

Zaman (2005) states that trade theorists insist that free trade generates more global wealth (under ideal conditions) and hence can lead to a Pareto improvement if the wealth is redistributed. At the policy level,

economists press hard for free trade but make no attempt to ensure that the redistribution will also take place. Applying lexicographic utilities to trade theory yields a new argument against free trade. Consider an agricultural economy consisting of peasants and a few rich landlords. In autarky, there is enough food for everybody. With free trade, the landlords will export food and other agricultural products, and import luxury goods. The price of foods will rise, and the quantity consumed domestically will fall, leading to the possibility that starvation/hunger will increase among the peasants. This will lead to a Pareto (L) inferior outcome from free trade.

Jeffrey Nugent (2002) from the University of Southern Carolina in his paper Trade Liberalization: Winners and Losers, Success and Failures s states that although least developed countries (LDCs) had concerns regarding trade liberalization that it would deteriorate their primary exports, it would have harmful effect of dependence on allegedly endemically unstable exports, that rich countries would benefit more and the main beneficiaries in LDC could be multinational companies (MNCs).

Grossman and Helpman (1991), and others have worked out examples where a country that is behind in technological development can be driven by trade to specialize in traditional goods and experience a reduction in its long-run rate of growth. Such models are in fact formalizations of some very old arguments about infant industries and about the need for temporary protection to catch up with more advanced countries. “The shock Doctrine” that ‘At the same time, Chileans were being thrown out of work because Pinochet's experiment with "free trade" was flooding the country with cheap imports. Local businesses were closing, unable to compete, unemployment hit record levels and hunger became rampant. The Chicago School's first laboratory was a debacle. He (Pinochet) took no pity on local companies and removed even more trade barriers; the result was the loss of 177,000 industrial jobs in Chile between 1973 and 1983.3 0 By the mid-eighties, manufacturing as a percentage of the economy dropped to levels last seen during the Second World War.

Dani Rodrik Dani Rodrik, (2000), a renowned Harvard economist who worked extensively with the World Bank says that when privatization and free-trade policies are packaged together with a financial bailout, countries have little choice but to accept the whole package. The really clever part was that the economists themselves knew that free trade had nothing to do with ending a crisis. New Risks in International Business, Free trade has led to "the creation of unprecedented wealth," but it has "immediate negative consequences for many." It "requires laying off workers. And opening markets to foreign trade puts enormous pressure on traditional retailers and trade monopolies." All these changes lead to "growing income gaps and social tensions”.

III. Research Methodology

The Case of Asian Tiger Economies

Naomi Klein “In the 90’s The Asian Tigers were certainly developing with whirlwind speed—but to suggest that their expansion was based on free trade was fiction. Malaysia, South Korea and Thailand still had highly protectionist policies that barred foreigners from owning land and from buying out national firms. They had also maintained a significant role for the state, keeping sectors like energy and transportation in public hands. The Tigers had also blocked many foreign imports from Japan, Europe and North America, as they built up their own domestic markets. They were economic success stories unquestionably, but ones that proved that mixed, managed economies grew faster and more equitably than those following the Wild West Washington Consensus. Walden Bello, the political scientist put it in this way "trade and investment protectionism and activist state intervention that were the key ingredients of the 'Asian Miracle”.

Model and Variable used

The following model used to check the correlation and significance of our study

$$MAnper = 2.228 + .297\ TOGDP + .015 inflation$$

S.E	(1.342)	(.044)	(.003)	
T-Stats	1.661	6.836	4.579	R-Square = .85

TOGDP = Trade Openness as a percentage of GDP

Manper = Manufacturing as a percentage of GDP

Data

The data used in this paper is taken from World Bank sources and include 30 years from 1980 – 2010.

Hypothesis

We would like to test that trade openness is negatively related to the manufacturing output over the period of 30 years. As the literature review says that by opening all trade barriers, it directly affects your manufacturing industry.

Manufacturing output is used as the dependent variable. It comprises of large scale manufacturing and small scale manufacturing. Trade openness includes the value of total trade, imports and exports. The unit used for all the variable is $.

H0: Trade openness has a negative impact on Manufacturing Sector

HA: Trade openness has a positive impact on Pakistan's Manufacturing Sector.

IV. Results

a. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.926(a)	.857	.846	.81473943

a Predictors: (Constant), TOGDP, Inflation

b. ANOVA(b)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	107.264	2	53.632	80.796	.000(a)
	Residual	17.923	27	.664		
	Total	125.187	29			

a Predictors: (Constant), TOGDP, Inflation

b Dependent Variable: MAnper

c.Coefficients (a)

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.228	1.342		1.661	.108
	Inflation	.015	.003	.414	4.579	.000
	TOGDP	.297	.044	.618	6.836	.000

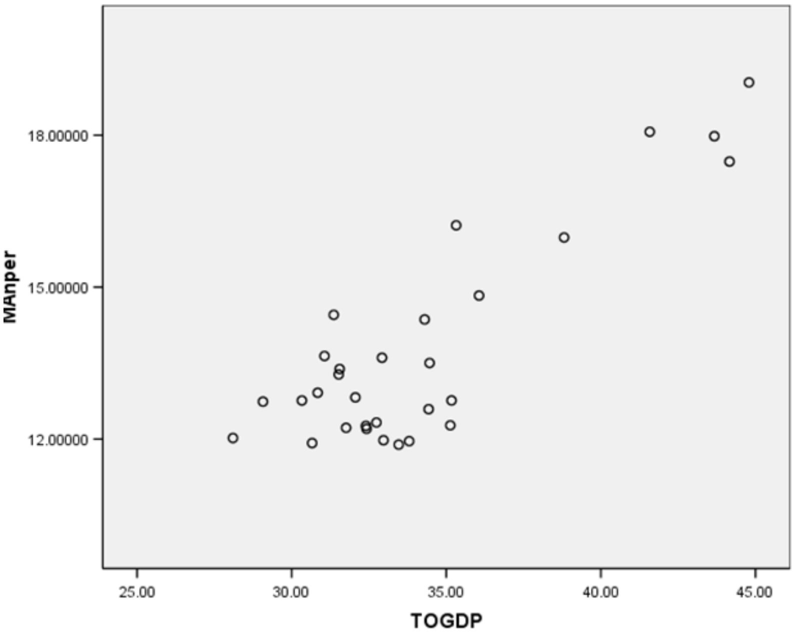
a Dependent Variable: MAanper

d. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
MAnper	30	11.89000	19.04200	13.7819667	2.07769022
TOGDP	30	28.10	44.79	34.2300	4.31820

By regressing the above mentioned model we found that he t –value associated with Trade openness as percentage to GDP is 6.836 meaning is statistically significant in predicting the manufacturing as percentage to GDP. The t-value associated with Inflation is 4.579 meaning it is also statistically significant.

When we see the β-value of Trade Openness to GDP, it's around .297 that means a one unit increase in our trade will affect our manufacturing by a magnitude of .297 and a unit change in Inflation will affect our manufacturing by .015.



By plotting the two variables, Trade Openness and Manufacturing as a percentage of GDP, we see a positive trend between the two which is also statistically verified.

V. Conclusions and Recommendations

Based on the statistical significance we reject our H0 and conclude that trade openness has a slightly positive impact on the manufacturing sector. However, point to note here is that even though it is statistically significant, the magnitude level is very low. The effect is around .297 which is just marginal. If we see the scatter plot, we can see that the gap between the Trade Openness and Manufacturing is large. Trade openness hit at 44% during the 30 years while manufacturing was on 19% at high during these 30 years. So even if there is a positive relation between the two, it is clear that the effect in magnitude is not significant. If trade was to have a positive impact on the GDP then it would have impacted the manufacturing sector with a much larger magnitude level. We can see that it does have an impact on the manufacturing but not as much as the literature suggest the importance.

If trade was not open we could have witnessed a much higher growth in manufacturing as the goods consumed were the same good that were produced in the country. The data show’s a clear picture that with such high level of trade our manufacturing level is not as high as suggested by the Free trade lovers. Trade openness is not advisable for developing countries. Even the developed countries started using trade liberalization policies when they were established enough; initially they were also using protective techniques in order to get themselves developed. Japan after World War 2 consumed their own goods despite the imported goods was relatively cheaper for them. We learn from history that trade liberalization policies is good for developed countries only and has not resulted a source of growth for under developed always. May be for developed countries but not necessary for under developed.

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